"Foreign exchange exposure and hedging: Evidence from foreign acquisitions"

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What is this paper about?

- Provide some explanations to the puzzling result of weak FX exposure of US firms by examining FX exposure of US acquirers of foreign targets
- Show that previous weak results could be explained by
  - measurement errors in time-series regressions,
  - not accounting for time variation in exposure
  - Use of exchange rate index vs. bilateral rates

Summary of the results of the paper

1. US acquirers of foreign firms with positive/negative average exposure pre-acquisition are significantly less exposed following acquisition
   - the acquisition serves as natural hedge against FX risk for net export/import acquirers
2. Financial hedging has no impact on changes in exposure following acquisition
   - But acquirers more often use currency derivatives
3. Not clear what explains the determinants of the change in exposure for net export/import acquirers

Related paper

- Akhigbe, Martin, and Newman (2003) examine shifts in exposure following cross-border acquisition announcements
  - They examine foreign acquisitions of US firms
  - Use a similar regression eq. as (2) of the paper with a dummy variable to measure risk shift, though do not allow for shift in market exposure
  - Firms characterized as either net exporters/importers experience a

Measuring exposure for acquirers of foreign firms

- Authors view:
  - Easy to identify the currency of exposure
    - that of the target firm
  - A time-period where exposure exists
- BUT not necessarily the case
  - Currency of determination of the target's business
  - No international involvement to the target firm's country does not imply no exposure,
    - the acquirer could be competing with importers originating from the target firm's country

Determinants of the change in exposure for net export/import acquirers

Independent variables

1. Size of the deal
2. Acquirer sell in the target country before
3. Use of derivatives on target currency
4. Use of foreign currency debt
5. Target exposure to $

Results (Table 7)

- Positive but insignificant
- Positive but insignificant
- Positive but insignificant
- Negative and insignificant
- insignificant

Revisiting the puzzle of weak FX exposure

- In the literature, lack of significance in FX exposure could be due to
  - use of an exchange rate index
  - constant exposure
  - measurement errors in time-series regression
  - choice of the sample of firms, typically multinational, large firms

Authors' contribution to the puzzle of weak FX exposure

- Lack of significance in the literature is due to
  - use of an exchange rate index:
    - BUT no consensus in the literature:
      - Bartram (2006) shows that the use of bilateral rates does not improve the measurement of exposure ,
      - Akhigbe et al. (2003) find less significant results with bilateral rates
  - constant exposure → the authors find significant changes in exposure following acquisition
    - the challenge is then how to model time-variation in exposure, see e.g. Chaieb and Mazzotta (2007)
  - Measurement errors in time-series regression

What else…

- The choice of the sample of firms, the authors focus on acquirers which are large and typically multinational firms
  - domestic firms with no direct international involvement are exposed

Summary

- Interesting paper: provides evidence for the relevance of FX exposure and some explanations to why previous literature fails to identify exposure among multinationals
- The importance of time-variation in exposure, accounting for cross-section dimension
- The identification of the key bilateral rates → NO consensus
- Further work is needed to explain the determinants of the change in exposure